Greater China – Week in Review

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Highlights

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The divergence between official PMI and Caixin PMI created confusion about the status of Chinese economy. Both data painted the contrasting picture of demand. The divergence may be due to two reasons. First, medium sized high-tech companies may get the most benefits from the tax incentive. Second, smaller companies may be more sensitive to change of risk sentiment.

Another confusion came from PBoC's skip of October TMLF as it deviated from PBoC's previous message that TMLF will be conducted in the fourth week of the first month of each quarter, which sent a signal of less accommodative monetary policy.

China's rates were caught in the perfect storm in the first half of last week with bonds being sold off due to improving risk sentiment, lack of willingness to ease monetary policy and rising supply side risk. Rates recovered partially thanks to weak official PMI.

China's State Council said on Friday in its latest meeting that the Chinese government will concentrate their efforts to keep China's growth at a reasonable range. It is good for risk sentiment. However, the impact on China's rates is likely to be limited as it is still unclear whether China will support the economy via easing monetary policy or alternative measures.

On trade talk, the road to phase one deal remained bumpy. The cancelation of APEC meeting in Chile meant the deadline for the phase one deal is no longer fixed. However, it will not affect the big picture that both sides are making progress to reach a deal.

In Hong Kong, the economy slipped into a technical recession in 3Q as widely expected but contracted more than anticipated by 2.9% yoy, the largest decline since 2Q 2009. The prolonged trade war continued to dent investment/consumer sentiment and drag down exports of goods. On top of this, the over four months of social unrest further weighed down fixed investments and private consumption (which together accounted for about 90% of total GDP) while hitting hard on the exports of services. Since August, the government has rolled out a raft of relief measures. This combined with a low base for 4Q, reduction in global risks and global monetary easing may allow 4Q's economic contraction to be milder than in 3Q. However, as the economy has contracted by 0.7% yoy during the first three quarters, a full-year recession now looks inevitable for 2019. Against a weak economic outlook, some commercial banks reduced the prime rate following Fed's rate cut last week, in a bid to bring some relief to their customers. Simultaneously, the banks cut the savings deposit rate. This may help to ease their funding pressure which has been rising amid elevated interbank rates and fierce competition for fixed deposits. Given low aggregate balance and uneven distribution of HKD liquidity across the banking system, HKD rates are likely to remain slightly elevated in anticipation of year-end effect, potential large IPOs (especially Alibaba's second listing) and virtual banks' upcoming soft launches. As such, the prime rate is unlikely to be cut further. On a positive note, unlike Global Financial Crisis which triggered panic sell-off of stocks and properties, the current economic contraction appears to have limited impact on market sentiments as HK's stock market rebounded on global risk-on sentiments while housing market continued to benefit from the relaxation of mortgage rules.

Key Events and Market Talk	
Facts	**OCBC Opinions**
▪ The road to phase one trade deal remained bumpy. Reuters reported initially quoting officials from White House that a phase one deal may not be completed in time for signing. ▪ Chile announced to cancel the APEC meeting due to domestic unrest. ▪ US Commerce Secretary Wilbur Ross expressed optimism to reach phase one deal in November. Meanwhile, he also said the licenses to grant US companies to sell to Huawei will be forthcoming soon.	▪ The cancelation of APEC meeting in Chile meant the deadline for the phase one deal is no longer fixed. However, it will not affect the big picture that both sides are making progress to reach a deal. ▪ We think the chance for a phase one deal is high.
▪ China's State Council said on Friday in its latest meeting that the Chinese government will concentrate their efforts to keep China's growth at a reasonable range and reiterated the importance of "six stability"	▪ The latest message from the State Council may reassure the market that China remain supportive to safeguard the growth. However, the impact on China's rates is likely to be limited as it is still unclear whether China will support via easing monetary policy or alternative measures.
▪ China did not conduct TMLF in October.	▪ The skip of TMLF caused confusion in the market as it deviated from PBoC's previous message that TMLF will be conducted in the fourth week of the first month of each quarter. Without further explanation from PBoC, market considered this as a signal that there is no room for further monetary easing.
▪ China's 10-year bond yield broke 3.35% last week before retreating to end the week below 3.3%.	▪ China's rates were caught in the perfect storm with bonds being sold off due to improving risk sentiment, lack of willingness to ease monetary policy and rising supply side risk. ▪ It was reported that Guangdong province will start to issue the new local government special bond soon using the newly allocated quota brought forward from 2020. For the remaining two months, it was estimated that CNY600-800 billion local government special bond may be issued which may add to supply side concerns.
▪ The HKMA followed the Fed's step to cut base rate by 25bps to 2% while Hong Kong's commercial banks also reduced the prime rate for the first time since 2008 by 12.5bps to the level seen before last September's hike. Simultaneously, the banks cut the savings deposit rate. ▪ Alibaba is reported to launch its second listing in Hong Kong in late November or December to raise up to US$15 billion. This could be the largest IPO in Hong Kong over the past few years.	▪ The commercial banks' latest move to raise the prime cap of HIBOR-based mortgages might have given them some room to cut the prime rate, in order to help ease the funding difficulty of the bank clients and to reduce the cost of savings deposits. ▪ The rate cuts, however, have barely affected HK's money market. On 31st October, USDHKD forward swap points and HIBORs moved up while USDHKD spot retreated on Alibaba headlines. Against the backdrop of low aggregate balance and uneven distribution of HKD liquidity across the banking system, HKD rates are likely to remain slightly elevated in anticipation of year-end effect, potential large IPOs (especially Alibaba's second listing) and virtual banks' upcoming soft launches. As such, the prime rate is unlikely to be cut further. Since the prime cap of HIBOR-based mortgages has been lifted lately, the small cut in prime rate last week may barely boost the housing market.

Key Economic News	
Facts	**OCBC Opinions**

▪ China's October PMI fell to 49.3 from 49.8 In September, weaker than market expectation. ▪ In addition, China's non-manufacturing PMI softened to 52.8 from 53.7.	▪ Both demand and supply softened in October. New order slipped to 49.6 from 50.5 while new export orders declined to 46.7 from 47.1. The softening demand may pour the cold water on risk sentiment which has benefited from the hopes on global recovery. ▪ The production slowed to 50.8 from 52.3 partly due to environmental protection as part of autumn clean to improve air quality prior to winter. ▪ Purchase price index eased again to 50.4 from 52.2. This may create the pressure on PPI again. We expect PPI to decline on month-on-month basis in October which may translate to decline of 1.8% yoy. ▪ On the positive note, the domestic facing manufacturing sector remained resilient. High-tech manufacturing PMI and consumer goods manufacturing PMI were at 51.4 and 50.8 above the threshold line of 50. ▪ The decline of non-manufacturing PMI to lowest since early 2016 may trigger concerns that the weakness may spread from manufacturing sector to non-manufacturing sector. However, given the number is still well above 50, we expect the domestic demand to remain resilient in the near term.
▪ China's Caixin PMI, however, recovered to 51.7 well above 50.	▪ The divergence between official PMI and Caixin PMI may be due to two reasons. First, medium sized high-tech companies may get the most benefits from the tax incentive. China's high-tech PMI for example remained above 50. Second, smaller companies may be more sensitive to change of risk sentiment.
▪ Hong Kong's economy (-3.2% qoq seasonally adjusted) slipped into a technical recession in 3Q as widely expected but contracted more than anticipated by 2.9% yoy, the largest decline since 2Q 2009. This was mainly attributed to the sharp decline in private consumption and fixed investment, which together accounted for about 90% of total GDP.	▪ The prolonged trade war continued to dent investment/consumer sentiment and drag down exports of goods (plunged for the second straight quarter by 7% yoy). On top of this, the over four months of social unrest further weighed down fixed investments (fell for the fourth consecutive quarter by the largest magnitude since 4Q 2008 of 16.3% yoy) and private consumption (dropped for the first time since 1Q 2009 by 3.5% yoy) while hitting hard on the exports of services (decreased by the most since 2Q 2003 by 13.7% yoy). As a result, despite the continuous growth in government expenditure (+5.3% yoy), GDP contracted for the first time in a decade. ▪ Since August, the government has rolled out more than HK$20 billion worth of off-cycle relief measures to help the households, SMEs and sectors that have been grappling with the persistent protests. This combined with a low base for 4Q, reduction in global risks as well as global monetary easing may allow 4Q's economic contraction to be milder than in 3Q. However, unless trade war and the protests come to an end, the economic growth may not be able to reverse the downtrend any time soon as trade, retail, catering, tourism, hotel and transport sectors would likely remain weak while consumer and investment sentiment may remain sour. As 3Q's contraction was more severe than expected and the economy has contracted by 0.7% yoy during the first three quarters, a full-year recession now looks inevitable for 2019.
▪ The decrease in Hong Kong's retail sales moderated	▪ Despite that, retail sales have dropped for eight consecutive

from the upwardly adjusted -22.9% yoy in August to -18.3% yoy in September, mainly due to low base effect.	months amid weak local consumption and visitor spending. Internally, the sales of food, alcohol drinks and tobacco and those of goods in supermarket dropped by 13.8% yoy and 2.6% yoy respectively as local households have been reluctant to go out amid social unrest and the consumption sentiment have been dented by the faltering outlook of economy and labour market. Externally, the sales of jewellery, clocks and watches (-40.8% yoy) and those of clothing, footwear and related products (-24.9% yoy) both dropped for the eighth consecutive month. Persistent protests have hit hard on the tourism sector (visitor arrivals continued to plunge by 34.2% yoy in September), which coupled with a strong HKD especially against RMB has suppressed visitor spending, Finally, as social unrest has disrupted the normal operation of department stores, the sales of goods in department stores tumbled by 25.6% yoy. ▪ Moving forward, as neither trade war nor social incident looks likely to end any time soon, we expect retail sales to continue showing double-digit year-on-year decline in the coming months. We hold onto our view that retail sales will drop by 10% this year. This would further push up the unemployment rate of the retail sector and weigh down the retail shop property market.
▪ Hong Kong's total loans and advances grew at a faster pace by 6.3% yoy in September.	▪ Trade finance has dropped for the 13th straight month by 2.1% yoy due to weak trade activities. The growth of loans for use in Hong Kong (excluding trade finance), which took up 65% of total loans and advances, accelerated to 7.2% yoy. As the government eased the mortgage rules for first-time homebuyers, mortgage demand looks set to grow further despite the elevated mortgage rates (normally 2.5% after the prime rate cut). Adding on positive outcome of US-China trade talks, it may help to partially offset the impact of local social unrest on local loan demand. ▪ Elsewhere, loans for use outside of Hong Kong increased at a faster pace by 5.9% yoy as the PBOC refrained from further easing after recent RRR cut. That said, the recent weakness in China's data and the stagnant credit spread may prompt the PBOC to cut RRR again in the rest of this year. Besides, overseas M&A activities have reduced while Mainland companies have preferred offshore bond issuance over offshore loans. Therefore, the growth of loans for use outside of Hong Kong may not be strengthen much further. ▪ In a nutshell, we expect the growth of total loans and advances to see low single-digit year-on-year growth in 2019.
▪ HKD loan-to-deposit ratio surged to 90.6% (a level last seen since March 2002) in September as HKD deposits rebounded by 0.6% mom and HKD loans grew by 1.1% mom. ▪ The composite interest rate increased to 1.02% in September from 0.97% in August.	▪ After briefly decreasing month-on-month in August, HKD deposits rebounded soon in September as IPO activities grew and commercial banks lifted HKD fixed deposit rates during the month. HKD CASA deposits dropped at a milder pace by 0.5% mom while HKD fixed deposits increased at a faster rate by 2.1% mom. In October, thanks to improved risk appetite, more IPOs returned with some seeing positive response. This suggests that HKD deposits (+1.8% yoy) would remain stable in October despite the ongoing social unrest. Adding on the relatively stable HKD and HIBOR, it reinforces that there is no

	sign of significant outflows. ▪ In terms of the composition of HKD deposits, the percentage share of HKD CASA deposits (dropped further to the lowest since January 2009 at 55%) may stabilize around the current level as the year-on-year decline in HKD CASA deposits (-7.4% yoy) are expected to moderate due to two reasons. First, Hong Kong's stock market rebounded thanks to improved global risk appetite. Second, property market regained growth traction owing to the government's relaxation of rules for first-home buyers. A stable share of HKD CASA deposits coupled with commercial banks' cut of savings deposit rate and the HKMA's move to reduce the CCyB ratio by 50bps to 2% is expected to help ease the funding pressure of banks. ▪ Still, as loan demand may remain benign amid external and internal uncertainties, we expect that any growth of HKD deposits will remain very moderate. Therefore, HKD loan-to-deposit ratio may remain elevated. Combined with the seasonal factors, potential large IPOs and virtual banks' upcoming soft launches, banks may still have to scramble for funds with relatively high interest rates in the rest of the year.
▪ Hong Kong's RMB deposits retreated by 3.2% mom to RMB623.4 billion in September.	▪ This might have been due to the rebound in HKD deposits during the same month amid higher interest rates. Going ahead, as RMB has stabilized on positive headlines about US-China trade talks while PBOC's relatively neutral stance has kept RMB yield elevated, we expect Hong Kong's RMB deposits to remain resilient above RMB600 billion in the coming months.
▪ Macau's gaming revenue retreated by 3.2% yoy in October.	▪ Though the mass-market segment has been supported by the resilient tourism where visitor arrivals and Mainland visitors grew by 11.5% yoy and 9.4% yoy respectively during the Golden Week Holiday, it failed to offset the weakness in high-roller demand which has been dented by a strong MOP, China's economic slowdown and policy risks. ▪ Going forward, after the holiday effect dissipates, we are concerned that the tourism growth will only be moderate due to a strong MOP, global economic slowdown and the spill-over effect of HK's social unrest. Therefore, we expect the growth of mass-market revenue will decelerate in 4Q while VIP gaming revenue could continue to drop. In conclusion, gross gaming revenue (-1.8% yoy during the first ten months of 2019) is expected to fall by around 2% in 2019.
▪ Macau's unemployment rate stabilized at 1.8% in 3Q 2019, whereas employed population dropped slightly from 387,300 to 387,100.	▪ Specifically, the employed population of construction sector registered the fifth consecutive decline of 6% yoy as the lack of new projects under construction weakened the relevant labour demand. Meanwhile, the employed population of retail sector (-3% yoy) and hotels and restaurants sector (-0.4% yoy) both dropped as faltering economic outlook dented both local consumption and visitor spending while a strong MOP further weighed down tourist expenditure despite resilient tourism growth. On a positive note, thanks to the buoyant mass-market segment supported by solid tourism growth, the employed population of gaming sector grew for the seventh consecutive three-month period by 0.6% yoy. ▪ Moving forward, as a lagging indicator, overall unemployment

	rate is expected to stagnate at 1.8% for a little while. That said, the labour market is set to soften as domestic economic outlook has been clouded by external uncertainties as well as a strong MOP. In other words, we hold onto our view that overall unemployment rate will climb gradually towards 1.9% and even 2% in the coming year. If this is the case, wage growth (median monthly earnings rose by 6.25% yoy to MOP 17,000 in 3Q) will likely slow down as well and further weigh down local consumption and housing demand.

RMB	
Facts	**OCBC Opinions**
▪ RMB strengthened against the dollar slightly last week tracking the broad dollar weakness. The SDCNY ended the week below 7.05. RMB index rebounded slightly to above 91.	▪ RMB continued to take the backseat without major breakthrough from the trade talk. The consolidation is expected to continue with the pair may track the broad dollar performance.

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